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*Webb* NIE 28.4-56  
21 August 1956

SEP 14 1956

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Nº 258

# NATIONAL INTELLIGENCE ESTIMATE NUMBER 28.4-56

## OUTLOOK FOR ICELAND

*Submitted by the*

### DIRECTOR OF CENTRAL INTELLIGENCE

*The following intelligence organizations participated in the preparation of this estimate: The Central Intelligence Agency and the intelligence organizations of the Departments of State, the Army, the Navy, the Air Force, and The Joint Staff.*

*Concurred in by the*

### INTELLIGENCE ADVISORY COMMITTEE

*on 21 August 1956. Concurring were the Special Assistant, Intelligence, Department of State; the Assistant Chief of Staff, Intelligence, Department of the Army; the Director of Naval Intelligence; the Director of Intelligence, USAF; and the Deputy Director for Intelligence, The Joint Staff. The Atomic Energy Commission Representative to the IAC, and the Assistant Director, Federal Bureau of Investigation, abstained, the subject being outside of their jurisdiction.*

DOCUMENT NO. 1  
NO CHANGE IN CLASS. I  
[ ] DECLASSIFIED  
CLASS. CHANGED TO: TS S (C)  
NEXT REVIEW DATE: 1991  
AUTH: HR 70-2  
DATE: 6-25-81 REVIEWER: 0092561

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## OUTLOOK FOR ICELAND

### THE PROBLEM

To assess the situation in Iceland with particular reference to the prospects for: (a) short and long term internal Icelandic stability; (b) the retention of US and NATO base rights; and (c) continued cooperation with the West.

### CONCLUSIONS

1. Isolationism, nationalism, and factionalism will continue to dominate political life in Iceland. All parties dislike the presence of US forces, although the Conservatives have a better appreciation of the need for them than do the Progressives and Social Democrats who, together with the Communist-dominated Labor Alliance, constitute the present government. This government is based on an uneasy coalition, and while it is highly unlikely that it will last the duration of this parliament (scheduled to run until 1960), it will probably remain in power at least until the base negotiations commence. (Paras. 39-42)

2. We believe that the present government will not abandon the principle that US forces must withdraw from Iceland. To keep the base at the operating level desired by the US or NATO military commands will probably exceed Icelandic capabilities for some years to come, and it is almost certain that Iceland will not create military forces of its own. While some settlement with the present government can probably be reached, we believe

that the Icelandic government will only agree to a settlement which involves reduction of US forces in Iceland. (Paras. 44-46)

3. The situation from the US and NATO point of view would probably be improved if the present government should collapse, since in view of the parliamentary situation, a successor government would probably include the Conservatives. Nevertheless, the trend of world events and of opinion in Iceland is such that, even under the most favorable domestic situation which we can foresee, original US and NATO objectives in Iceland will almost certainly not be realized. (Para. 48)

4. Iceland's economy will continue to be vulnerable since it depends on the sale of fish in the international market, and on US base expenditures. Without the latter, Iceland's economy may become dependent on the Soviet Bloc. (Paras. 11, 18, 25)

5. The Communists have a dominant position in the Icelandic Federation of

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Labor, and in the recent national election they polled one-fifth of the votes. They pose a potential threat to constitutional government in Iceland. Their participation in the present government gives them an opportunity to increase their influence. Their general objective is the neutralization of Iceland as a participant in the Western defense effort,

with the removal of US forces as the immediate target. While US forces remain in Iceland, we believe that the Communists will not attempt a *coup d'etat*. If US forces were withdrawn, a *coup* would be unlikely unless such action were related to a Soviet move involving considerably more than Iceland itself. (Paras. 34-36)

## DISCUSSION

### I. INTRODUCTION

6. Despite the changes wrought by its emergence from isolation during World War II, Iceland is still greatly influenced by its long history of limited contact with the outside world. Life in small isolated communities with very little class consciousness or religious differences has produced an independent, equalitarian, and democratic people intensely interested in local affairs. A pervading nationalism, nurtured by a long struggle against Danish domination, is reflected principally by a deep pride in Iceland's culture. The introduction of alien forces and an alien culture by first British and then US occupation during World War II provoked considerable dissatisfaction, but the concurrent German occupation of Denmark also provided an opportunity for the Icelanders finally to terminate their ties with Denmark. Iceland became independent in 1944.

7. After the war Iceland attempted to resume its aloofness from world affairs, but with the increase of international tensions which occurred in 1947-1948, it began once again because of its location to assume great strategic importance. With considerable reluctance, Iceland joined NATO in 1949, and in May 1951 — under stimulus of the further rise in international tensions caused by the Korean conflict — the Icelandic government signed a defense agreement with the US under NATO auspices. Under this agreement the US expanded the Keflavik airport, and stationed

considerable forces there. Iceland now provides the US and NATO:

a. A key link in the Early Warning System for the defense of the US and other NATO countries.

b. An important base for antisubmarine operations.

c. Forward logistic support for Striking Fleet operations.

d. A significant air base for implementation of NATO requirements.

e. A key communications link between the US, UK, and other NATO countries.

8. However, these various developments have added to the political ferment which had resulted from occupation of the island during World War II and from the impact of wartime and postwar economic expansion. There were considerable doubts that Iceland had taken the proper course in altering its traditional policy of abstention from world affairs. As early as December 1953 the Icelandic government negotiated changes in the Defense Agreement giving Icelandic contractors a greater share in construction activity at the US base. At the same time, Iceland imposed additional restrictions on the movement of US personnel outside the base area.

9. Those elements in Iceland which had never been sympathetic to the treaty with the US stepped up their attacks on the Defense Agreement after the Summit Conference of 1955 and the relaxation of tensions in Europe which followed. Such developments as the return of Porkkala to Finland by the USSR impressed

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the Icelanders, and lent weight to the argument that the US should similarly evacuate Keflavik. Finally, the parliament (Althing) approved a resolution on 28 March 1956 calling for discussions with the US on revision of the treaty, aiming for the withdrawal of US forces from the country, and having Iceland assume the responsibility on behalf of NATO for maintenance of the installations. Except for the Conservatives, all political parties supported the resolution.

10. The parliamentary resolution calling for revision of the treaty was not, however, solely the result of a resurgence of Icelandic nationalism or of the relaxation of tensions in Europe. Iceland's internal political rivalries, economic problems, and an increasing Soviet Bloc campaign to acquire greater influence in Iceland, all contributed to the passing of the resolution. Although the reappraisal within Iceland of the nation's position with respect to the outside world is not completed, the elections in June 1956 gave a parliamentary majority to parties favoring the withdrawal of US forces, and a coalition government was formed with Communist participation. However, whether Iceland continues its military and political association with the Atlantic powers or eventually seeks refuge in neutrality, developments in the Icelandic economy since Iceland's emergence from isolation have made the country more dependent than ever before upon its foreign trading and financing arrangements. Indeed, Iceland's economic problems greatly affect both its internal politics and its foreign policy.

## II. ECONOMIC SITUATION AND TRENDS

### Nature and Expansion of the Icelandic Economy

11. Although there has been considerable economic diversification and expansion since 1940, Iceland's economy is still basically dependent upon the fishing industry, which is the source of 90 to 95 percent of its export earnings. Accordingly, Iceland's economic well-being is extremely dependent on the size of fish catches and the world market for fish. During World War II a heavy demand for fish

in Britain combined with US and UK expenditures in Iceland to produce a period of unprecedented prosperity. Gross national product (GNP) in real terms approximately doubled from 1938 to 1947.

12. The departure of US and UK forces from Iceland and a succession of poor fishing years halted the growth of GNP from 1947 to 1951. However, economic expansion was resumed in the latter year and by 1955 GNP was almost three times greater than the prewar level, amounting to \$180 million, which, on the basis of a population of approximately 160,000, amounted to a per capita product of over \$1,100. That expansion in GNP was due to several factors. The terms of trade improved after the outbreak of the Korean war; an ambitious investment program to diversify and expand the Icelandic economy began to acquire momentum; and, most important, US expenditures connected with the Keflavik air base stimulated the economy. In addition, between 1945 and 1955, US loans and grants to Iceland have amounted to nearly \$50 million.

13. Iceland's development program aims at modernization of agriculture, expansion of the fishing industry, and some industrialization. In 1950, a 10-year project for agricultural development was begun, envisaging an increase in Iceland's agricultural output by 50 percent, primarily through large-scale mechanization of farms to alleviate the shortage of labor. The tonnage of the fishing fleet has been more than doubled since 1938. The productive capacity of freezing plants has increased more than six times, and that of the herring and fishmeal factories approximately four times. Shipyards and engineering workshops have been modernized, an extensive electrification program has been undertaken, and a number of plants producing building materials, including cement, have been constructed. The government has stated its intention of seeking foreign loans to expand its trawler fleet, to develop water power and port facilities, and to extend the development of industry and agriculture.

14. These postwar programs for economic expansion were reflected in a remarkably high

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rate of investment, reaching a peak in 1946 and 1947 of approximately 36 percent of GNP. A decline to 20 percent occurred in 1950, but with the signing of the Defense Agreement in 1951 and renewed US activity at the Keflavik air base, the share of investment again rose to 33 and 35.5 percent of GNP in 1954 and 1955, respectively.

15. Although the fishing industry is still Iceland's most important enterprise, heavy investment and rapid economic growth have produced profound changes in the country's economic structure. While in 1940 more than 46 percent of the population derived its livelihood from agriculture and fishing, by 1950 only 31 percent were employed in these basic fields. The proportion in industry and construction increased from 21 to 31 percent between 1940 and 1950, and these trends are still continuing.

16. Iceland's total foreign trade has increased by 87 percent since 1950. Imports have greatly exceeded exports, however, creating a serious foreign exchange problem which has been only partly alleviated by US grants, loans, and expenditures at the Keflavik base. Capital goods represent 40 percent of total imports. Production of import-substituting goods will be the main result of the economic diversification taking place, but — since these new industries are still in an early stage of development — such production will not result in reduced imports for some time. In 1954 and 1955, which were good fish years, exports reached new peaks, but Iceland's trade accounts for those years showed an import surplus of \$17.5 million and \$25.6 million, respectively.

### Economic Impact of the US Base Program

17. The various changes in the Icelandic economy would not have reached their present magnitude except for US economic aid and the US base program, which helped to provide Iceland with the foreign exchange necessary for economic development and generally to raise the level of employment and incomes. During 1953 US Defense Force expenditures represented 10 percent of Iceland's GNP, and

in 1954 and 1955 about eight percent. During these same years Iceland's GNP, in real terms, rose by slightly over 10 percent annually. In the past three years, receipts from the base program have averaged about \$15 million annually, and amounted to 62 percent of Iceland's deficit in the balance of trade in 1953, 86 percent in 1954, and 55 percent in 1955.

18. The withdrawal of US forces and a termination of defense expenditures in Iceland would have severe consequences for the Icelandic economy, which is now geared to maintenance of at least the present level of Defense Force spending. Either the foreign exchange gap would be more than doubled or the level of imports would have to be reduced. The Icelandic government would thus be pressed to seek alternative sources of foreign exchange, and would be inclined to increase its economic cooperation with the Bloc.

### Inflationary Pressures

19. The Keflavik base and construction program has been partly responsible for an increase in inflationary pressure in the Icelandic economy by adding to purchasing power and by absorbing a significant portion of the country's labor force during a period of full employment. Employment on the base reached four and one half percent of the total labor force in 1953, and the Icelandic government became alarmed at the labor shortage which had developed. As a result of Iceland's request, employment at the base has been reduced. However, Iceland's current problem of inflation stems in large part from an excessive rate of investment, particularly in such nonproductive fields as residential housing, and from an over-expansion in bank credit.

20. In 1946 the Icelandic cost of living index was three times that of 1937, and has doubled since 1946. The krona has been devalued twice since 1945, and it is at present worth only about one-fourth of its prewar dollar value. A widespread strike for higher wages in 1955, which produced increases of 10 to 15 percent, added a new inflationary factor. Since agricultural prices are fixed annually on the basis of wage levels, these prices rose by about 14 percent.

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21. The physical volume of production rose by nine percent in 1955, but was outstripped by an increase in bank credit of 22 percent, and by money in circulation of 13 percent. There has been a loss of public confidence in the stability of the krona, and there has been a substantial decrease in new savings. Although the Icelandic government exerts considerable control over the economy through government ownership and regulation of a large share of the means of production, licensing of exports, and rationing of foreign exchange, no central bank exists with the power to carry out effective monetary policies.

### Foreign Trade<sup>1</sup>

22. From 1945 to 1953 the US and UK were Iceland's largest customers and, together with Western European countries, received the vast bulk of Icelandic exports. The Soviet Bloc accounted for only seven percent of total exports in 1952. Subsequently, however, the combined share of the US and UK has declined sharply while that of the Bloc has increased considerably. By 1955 the Soviet Union was Iceland's largest single customer, and the Bloc was taking nearly 30 percent of Iceland's total exports, exceeding the share of the US and UK combined. A parallel pattern has developed with regard to Icelandic imports. Although the US is still the greatest single supplier of imports, providing about 23 percent of the total in 1955, the share of the UK has dropped from almost 30 percent in 1951 to approximately 10 percent in 1955. Purchases from the Soviet Bloc, on the other hand, have risen from seven percent of total imports in 1952 to 22 percent in 1955.

23. This drastic change in Iceland's pattern of trade is partly attributable to the landing ban on Icelandic fish imposed by British fishing interests in 1952 in response to an Icelandic extension of the fisheries conservation limit and the closing of Iceland's fjords to all trawlers, including their own. Iceland's dependence on fish exports made the development of alternative markets imperative, and a trade agreement was signed with the USSR in 1953.

<sup>1</sup>See Appendix A for the geographic and commodity distribution of Iceland's foreign trade.

The Soviet Union agreed to take large quantities of Iceland's frozen and salted fish in exchange for providing Iceland with almost its entire requirements of gasoline, fuel oil, and cement, as well as large amounts of iron, steel, and grain.

24. Since the imposition of the landing ban, that sector of the Icelandic fishing industry devoted to the marketing of fresh fish has largely shifted to the production of frozen fish. Accordingly, even if a settlement of the Anglo-Icelandic dispute should be reached, Britain, not being a purchaser of frozen fish, probably would not regain its former significance as a market. At the present time, the US, the USSR, and Czechoslovakia buy 90 percent of Iceland's total exports of frozen fish, with East Germany accounting for another five percent.

25. While there is some concern in Iceland about the large volume of trade with the Soviet Bloc and the potential threat to the country's freedom of action which this entails, Iceland is committed to the economic development program, and no Icelandic government could afford to allow it to flounder because of inability to obtain necessary imports. The Bloc has gained an important position in the Icelandic market, at the expense of US and UK suppliers, particularly in the field of petroleum and petroleum products. Icelandic purchases of capital goods and machinery from the Bloc necessarily involve a dependence upon it for replacements and spare parts. So long as Western markets do not absorb Iceland's exports, trade with the Soviet Bloc will almost certainly continue and probably increase.

### Soviet Bloc Economic Assistance

26. In addition to carrying on a substantial trade with Iceland, the Soviet Bloc has made offers of economic assistance in the form of loans. In late 1954, the USSR, Czechoslovakia, and East Germany offered to construct and supply equipment for a cement plant, after the International Bank for Reconstruction and Development had refused to grant a loan for the project. Iceland finally decided not to accept the Bloc offer, and awarded the

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contract to Denmark. An offer by the USSR of \$6 million to help form an oil distributing company has not been acted upon by Iceland; acceptance could extend the USSR's hold on Iceland's petroleum market. Czechoslovakia has offered an interest-free loan to provide the equipment for construction of a large hydroelectric plant on the Sog river. This is the most important single project of Iceland's development program, and it is probable that Iceland will accept the Czechoslovakian offer unless a comparable Western offer is made.

27. The only contract so far concluded with a Bloc nation by Iceland was with Czechoslovakia in March 1956 for \$1.7 million in equipment for hydroelectric plants and transformer stations. Czechoslovakia has given Iceland a four year credit at four percent interest on 70 percent of the value of the contract, with the loan to be paid in fish and fish products within one year after delivery of the equipment.

### III. POLITICAL SITUATION AND TRENDS

28. Although Icelanders are united by racial and cultural homogeneity, their highly individualistic nature and intensity of interest in domestic politics together with the extraordinary importance of personal loyalty and influence cause sharp political differences. No party has received a parliamentary majority for over 25 years. Cabinets are characterized by weakness and dissension, and fundamental problems are dealt with in a makeshift and partisan manner. Thus, while it is generally accepted that the basic objective of domestic policy is maintenance of the nation's recently-acquired higher standard of living, the identification of political parties with fairly well-defined interest groups prevents sound and generally acceptable compromises in economic policy. The result is the compounding of economic difficulties, which in turn intensifies the basic political instability.

#### Political Parties

29. The largest Icelandic parties are the Conservatives and Progressives, in that order.

The Conservative Party, strongest among independent fishing interests and importers, dominated the government from 1944 until the recent elections. The Progressive Party is supported by rural groups, including the influential cooperative movement. Both parties, and particularly the Conservatives, attract a sizable labor vote. In addition to the usual differences which exist between urban and farm elements in any society, the interests and attitudes of the Conservative private fishing and importer groups are in conflict with those of the cooperative and agrarian supporters of the Progressives.

30. While in foreign policy the Progressives have traditionally been more nationalist and isolationist than the Conservatives, the differences between these parties over the presence of US forces on the island are based primarily upon domestic political and economic interests. The Conservatives have officially taken the position that, although US troops should not remain in Iceland longer than is required by the security of Iceland and other NATO members in the North Atlantic area, there should be careful study of the international situation and the problems involved in the withdrawal of the US garrison before any decision is made. This position reflects the dependence of its leaders and many of its supporters on a high level of international trade for a livelihood, as well as the economic benefits Conservatives and other urban elements derive from the presence of the US forces. The Progressives, whose rural supporters derive little direct economic benefit from the US base, argue that US forces should be withdrawn, and that Icelanders should man the base on a caretaker status. The leadership of the Progressive Party has adopted this policy to insure political survival. Increasing urbanization and industrialization of Iceland are resulting in the gravitation of the new city population to the urban parties, particularly the Conservative. Progressives argue that these changes are diluting the traditional Icelandic way of life, and that Iceland is becoming dangerously dependent on income from the base, which may not continue indefinitely.

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31. The Social Democrats are a small party in Iceland, contrasting sharply with the predominance of Socialists in other Scandinavian countries. The weakness of the Social Democrats is attributable to several factors. There is little sense of solidarity among the workers. The rural-urban split among voters is more important than class consciousness, and a large number of workers have identified themselves with the Conservatives as an urban party rather than with the Socialists as a class party. Many of those workers who do discern a class conflict appear to prefer the Communists. The Social Democratic leadership tends to be academic and theoretical, and has accomplished little through its participation in various coalition governments. A damaging Social Democratic split developed in 1938 over the issue of collaboration with other parties, one group favoring the Conservatives and Progressives, while the other preferred cooperation with the Communists. A similar intraparty conflict led to the loss of control over the Icelandic Federation of Labor to Communists and left-wing Social Democrats in 1954.

32. The Communist Party, using the name "The United Peoples Party—the Socialist Party," has consistently outdrawn the Social Democrats at the polls since 1942. Although Communist strength is derived primarily from a large sector of the labor movement, they also attract votes from other groups, particularly intellectuals and artists. Enjoying a unity of leadership unmatched by the other parties, the Communists, in marked contrast to the Social Democrats, have attracted labor and other supporters by aggressive advocacy of a leftist economic and social policy. Moreover, the Soviet leaders do not appear to have insisted upon a rigid adherence to Moscow, and have permitted a considerable degree of intellectual and tactical freedom. Aided by the prevalent Icelandic belief that they constitute essentially an indigenous and patriotic group, the Communists have also appealed with considerable success to extreme nationalist and isolationist sentiment in their campaign against NATO and the stationing of US forces.

33. The Communists have been a major factor in Icelandic politics since the mid-thirties. With the Conservatives and Socialists, the Communists participated in a three party coalition government from 1944 to 1947. In the 1949 general elections, they won 14,000 votes, or 19.5 percent of the popular vote. In 1953 their vote fell to 12,500 and their percentage to 16.5. In the 1956 elections, through the device of a "Labor Alliance" with a few left-wing Socialists, the Communists won almost 16,000 votes and 19.2 percent of the total vote. The hard core of the party is estimated to number about 1,000, and this group is almost certainly responsive to Soviet direction. With the presence of a Soviet mission in Iceland, there are no obstacles to consultation with the USSR or to the receipt of financial assistance.

34. In the trade union field, the cleverness and energy of the Communists have paid rich rewards. In contrast with the conservative and uninspired Social Democratic leaders, the Communists have displayed an aggressive policy which has proved highly successful in developing the trade union organization and winning wage increases. The Communists have the support of about one-third of the labor movement. They control two of the largest unions in the country, and they recaptured domination of the Icelandic Federation of Labor in 1954, after having lost their predominant position in 1948. They will almost certainly retain, if not strengthen, their hold on the Federation at the forthcoming biennial meeting. The Federation has about 26,000 members and represents 85 percent of organized labor. In addition, the Communists control the important society of grocery cooperatives in Reykjavik, and have penetrated the educational system, the state radio, and the civil aeronautics administration.

35. The Communists, therefore, are a potential threat to constitutional government in Iceland because of their participation in the government, their predominance in the trade union movement, particularly in Reykjavik, and their substantial popular support. Their present general objective is the neutralization of Iceland as a participant in the Western de-

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fense effort. Beyond that, they will continue to attempt to turn public opinion against participation in NATO and the maintenance of the Keflavik base, and to foster neutralism and economic dependence on the Soviet Bloc. In pursuing these objectives they will rely particularly on the tactic of forming fronts with non-Communist groups in order to exploit popular causes.

36. While US forces remain in Iceland, we believe that the Communists will not attempt a *coup d'etat*. Should US forces be withdrawn, the Icelandic government would be dependent on about 200 police plus the fisheries patrol service of less than 200 to suppress any attempt against it. We have no evidence that the Communists now have the arms or the training necessary for carrying out any plan to take over the government, and it is unlikely that an attempt to acquire these would escape the attention of the government and other important Icelanders. Whether US forces were in Iceland or not, we believe that the Communists would not attempt a *coup*, unless such action were related to a Soviet move involving considerably more than Iceland itself.

### The Elections and the New Government

37. The substance of the Althing resolution passed earlier in the year was the chief issue before the electorate on 24 June 1956. Only the Conservatives favored a delay in a decision to withdraw US forces, arguing that ac-

tion should not be undertaken on the parliamentary resolution until a report had been received from NATO regarding the need for forces in Iceland. The Progressive-Social Democratic alliance favored continuation of Icelandic ties with NATO, but advocated an early decision for withdrawal of US forces and the transfer of operational and maintenance responsibility to the Icelanders. The Communist-dominated Labor Alliance took no position on NATO, but joined the Progressives and Social Democrats in support of an early decision on the withdrawal of US forces. However, the base issue was only a focal point around which other issues — principally economic — turned. The shortage of farm labor and the rising cost of living were serious problems, and the political campaign provided opportunities for assigning the blame. Those who received no direct benefit from the base development program and suffered from rising prices were quick to lay all the fault to the presence of US forces. The Communists, who had successfully led the 1955 strike for higher wages, made political capital out of the gains being made by "profiteers" and out of proposals to nationalize the trawler fleet.

38. The Conservative Party received a higher percentage of votes than any other single party. It registered a gain, while the alliance of the Progressives and Socialists, taken as a bloc, declined in percentage of votes compared with the elections in 1953, despite the fact that they did not run against each other. The Com-

Party <sup>2</sup>	1953		1956	
	Percentage	Seats	Percentage	Seats
Conservative	37.1	21	42.4	19
Republican	3.3	0	—	—
Progressive	21.9	16	33.8	17
Social Democrat	15.6	6		8
Labor Alliance (Communist-dominated)	16.1	7	19.2	8
National Defense	6.0	2	4.5	0

<sup>2</sup> The Republican Party was formed in 1953 by an ultraconservative group of businessmen and other commercial interests dissatisfied with the recent Conservative-Progressive government's economic policies. It did not enter the 1956 campaign, and its supporters almost certainly voted for the Conservatives, contributing to the latter's gains. The National Defense Party was founded in 1953 almost solely for the purpose of advocating the withdrawal of US forces from Iceland. This party draws support from former Progressive, Socialist, and Communist voters.

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munists registered a clear gain of three percent, probably at the expense of the Socialists. Because the electoral law results in an overrepresentation of the rural areas, the distribution of parliamentary seats fails to reflect the popular view insofar as the Progressives and the Socialists increased their representation while the Conservatives lost seats. Comparisons between popular vote and parliamentary representation resulting from the 1953 and 1956 elections are shown in the table on page 8.

39. The parliamentary situation clarified when the leadership of the Progressive and Social Democratic parties agreed to offer the Communist-dominated Labor Alliance participation in the government, thus opening the way for a majority three party coalition, leaving the Conservatives in opposition. After lengthy negotiations an agreement was reached under which Hermann Jonasson, the opportunistic Progressive leader who was largely responsible for precipitating the defense problem, became Prime Minister, with one additional cabinet office for the Progressives, two for the Social Democrats, and two for the Labor Alliance. A Social Democrat is Foreign Minister, a Communist member of the Labor Alliance is Minister of Trade and Fisheries, and a renegade Social Democratic member of the Labor Alliance is Minister of Social Affairs and Labor.<sup>3</sup> While the key positions of Prime Minister and Foreign Minister are not under Communist control, the Communists are represented in the government of a NATO country for the first time since this alliance was constituted.

40. The Communist-dominated Labor Alliance was anxious to enter the government in order to promote the neutralization of Iceland, abet Communist penetration of official agencies, and advance the political fortunes of the Communist Party. To secure this extraordinary opportunity to influence Iceland's foreign and domestic policies, the Communists demonstrated considerable flexibility, illustrated by their acceptance of a pro-NATO Social Democrat as Foreign Minister. Moreover, the

<sup>3</sup> See Appendix B for a list of leading Icelandic political personalities.

Communists were in a strong position in the interparty negotiations. The Progressives and Social Democrats, prompted by a series of electoral losses, hoped to use the powers of government to enhance their waning prestige and undermine the political and economic power of the Conservative opposition. Moreover, the Progressives and Social Democrats feared that the Conservative and Labor Alliance members of parliament would combine to prevent the seating of some Social Democrats and revise the electoral system to the detriment of the overrepresented Progressive Party. The Progressives and Social Democrats had no important disagreement with the Communists on the base issue. Thus, despite some misgivings, the Progressive and Social Democratic bloc felt constrained to form a majority cabinet with the Labor Alliance, feeling confident that they could dominate the coalition.

41. We believe that the present coalition will prove an uneasy alliance. The Communists and many Social Democrats are especially bitter political enemies. Opposition within the Social Democratic and Progressive parties to cooperation with the Communists poses a potential threat to the existence of the government by limiting the capacity of these parties to compromise with the Labor Alliance. Moreover, the Social Democrats, who have been obliged to make concessions on domestic policy and are distrustful of the Progressive leadership, are likely to become increasingly restive in the government. We believe that the Communists will, at least during the next several months and probably longer, follow a moderate course. We believe that they are more anxious to retain cabinet office, and particularly control of trade and fisheries, and to attain greater influence and respectability than to make a probably fruitless effort to obtain a Communist solution of the base question.

42. We believe the present government will probably remain in power at least until the base negotiations commence. The chances are better than even that the Communists will not precipitate a crisis over the defense issue.

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Nevertheless, we believe that domestic issues will eventually bring the basic divergencies within the coalition to the fore, making it highly unlikely that the coalition will last the duration of this parliament, which is scheduled to run until 1960. In the event of a collapse of the present government, the two most likely alternatives are a reinstitution of a center-right coalition involving the Conservatives, or new elections.

#### IV. PROBABLE DEFENSE POLICY

43. The new government's announced policy is to remain in NATO and to maintain and guard the Keflavik base with Icelandic personnel, so that US forces can leave the country. To give weight to its position, the government has repeated the threat contained in the parliamentary resolution to abrogate the defense agreement if Iceland's demands on the troop issue are not met. The government has not publicly acknowledged the probably severe effect upon the Icelandic economy of the withdrawal of US forces or the discontinuance of the base development program, and in fact believes that some US base construction and economic assistance will continue even if US forces are withdrawn. In view of the recent Soviet Bloc offers of loans and the designation of a Communist as Minister of Trade and Fisheries, the government probably believes — and with justification — that the USSR and the Eastern European satellites will come forward with economic assistance.

44. We believe that the present government will not abandon the principle that US forces must withdraw from Iceland. The stationing of foreign military personnel in Iceland in peacetime is unpopular, even among the Conservatives, and the government has publicly committed itself on this issue. Concerning the time and manner of the withdrawal, however, and the possibility of leaving some US units in Iceland, there is almost certainly some room for negotiation and some doubt in the minds of Icelandic leaders. The present government would probably agree to a phased withdrawal of military technicians and the substitution of US civilians over an extended period. It might also agree to the phased

withdrawal of other US armed forces. The attitude of the Icelandic government will be influenced to some extent by the obvious economic advantages of a continued flow of US dollars, but economic interest will probably not offset the strongly nationalistic policies of the present government.

45. While some settlement with the present government can probably be reached, much will depend upon the development of the internal political situation in Iceland and upon the atmosphere in which negotiations are conducted. US offers to train an increasing number of Icelanders for duties at the base, including guard duties, might lead to some softening of the government's position, particularly if the coalition were being strained by other issues. Nevertheless, we believe that the present government will only agree to a settlement which involves reduction of US forces in Iceland.

46. In any event, however, Iceland alone would be unable to maintain the base at the current level. It has the necessary qualified personnel to operate the airport and probably to carry out the housekeeping functions essential to maintenance. But to keep the base at the operating level desired by the US or NATO military commands will probably exceed Icelandic capabilities for some years to come, and it is almost certain that Iceland will not create a military force of its own.

47. It is improbable that the Progressives and Social Democrats fully realized that their coalition with the Communists would bring into serious question the tenability of Iceland's membership in NATO. They appear to have assumed that Iceland would remain a full and equal partner in the alliance regardless of the make-up of its government. Consequently it is probably with some surprise that they are now beginning to realize the difficulties connected with their membership in NATO which arise from the presence of Communist members in the government. Although few Icelanders are deeply devoted to NATO, a large number would oppose separation from it because it represents both a relatively inexpensive insurance of national security and a symbol of Iceland's political, eco-

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nostic, and cultural association with the West. Thus, if Communist participation in the government led gradually to the virtual exclusion of Iceland from NATO, it could cause serious strains in the coalition. If the government were already weakened by other issues, the controversy over NATO could cause it to fall. On the other hand, if other NATO members moved at an early date or in an abrupt manner to exclude Iceland from participation in NATO proceedings, the effect would probably be to solidify the present government and provoke it to withdraw from NATO.

48. The situation from the US and NATO point of view would probably be improved if the present government should collapse, since in view of the parliamentary situation, a successor government would probably include the Conservatives. Nevertheless, the trend of world events and of opinion in Iceland is such that, even under the most favorable domestic situation which we can foresee, original US and NATO objectives in Iceland will almost certainly not be realized.

## V. THE LONGER-TERM OUTLOOK

49. While the prospects for Icelandic agreement to the retention of any substantial number of US forces in Iceland are poor, this does not mean that Iceland is becoming anti-Western or pro-Soviet. The widespread feeling against the presence of foreign troops has not resulted in manifest anti-Americanism. The US is still popular in Iceland, and the election results in the populous areas near the US base even demonstrated a positive desire to have the base maintained. The only Western country which is genuinely unpopular is the UK; its ban on Icelandic fresh fish came at a time when Iceland was already in a difficult competitive position. The failure to settle the dispute has created ill-feeling which will take considerable time to dissipate.

50. When Iceland reluctantly accepted US forces, the blame for this onerous necessity was placed upon the USSR by the vast majority of Icelanders. More recently, Icelandic fear of Soviet aggression has been eroded by the Soviet effort to relax tensions, the Soviet cultural program in Iceland, and the extensive

trade developed with the Bloc. The belief is growing that a normal intercourse between the West and the Soviet Bloc can be attained. Nevertheless, Iceland's cultural ties are with the West, particularly with the Scandinavian countries. Communism, or a close political relationship with the Soviet Bloc, would be fundamentally inconsistent with the entire Icelandic tradition.

51. Nevertheless, while some Icelanders are aware of the dangers of Communism at home, most of them still take a complacent attitude toward this threat. As indicated above, this is due to the skill of the Communist leadership, the weakness and incapacity of the Socialist leadership, and the parochialism which puts its faith in Icelandic culture and discounts the possibilities of Soviet influence. Moreover, as a result of their participation in the present government, the Communists will have new opportunities to infiltrate public agencies and private organizations. Their influence will probably increase, particularly if they conduct themselves moderately and with a patriotic facade.

52. On the other hand, the increased Conservative popular vote in the recent elections is an encouraging sign. Moreover, the unwillingness of a great majority of Social Democrats to join the Labor Alliance demonstrates an awareness of the dangers of electoral cooperation with the Communists. It is possible that the results of the recent elections and the entry of the Communists into the government will shake the complacency of the more conservative elements and that, even though Communist influence may increase, the determination and influence of anti-Communist elements will also increase.

53. The greatest dangers to moderate government in Iceland stem from the country's fragile economic structure. The dependence upon the size of the fish catch and upon the international fish market is in itself a serious vulnerability. Moreover, stimulated by foreign credits and extraordinary US dollar expenditures in Iceland, there has been an excessive investment in nonproductive facilities, and an overexpenditure in imported consumers' goods. Serious deterioration in

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the economy, through an inability to sell abroad, a failure to acquire the necessary imports to complete the development projects underway, or a further inflationary spiral which undermined Iceland's competitive position, would almost certainly strengthen extremist elements in Iceland and increase political instability.

54. If Iceland can cope with its serious economic problems without becoming dependent on the Soviet Bloc, it is probable that moderate elements will over the longer run resume

full control of Icelandic politics. Commercial and cultural contacts with the Bloc will probably be expanded. These contacts, and a continuance of a relaxed international atmosphere in Europe, would cause almost any government to drift away from close cooperation with the principal NATO powers. The chances for moderate government and for continued close ties with the NATO powers would be substantially improved if Iceland could develop adequate markets and sources of supply in the Western countries.

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APPENDIX A

Pattern of Iceland's Exports, 1938-1955  
(Percentage Distribution by Destination)

	1938	1951	1952	1953	1954	1955
United States	9.1	18.2	24.6	15.3	17.0	11.6
United Kingdom	20.5	23.4	13.9	10.4	9.3	8.3
Soviet Bloc	1.2	7.8	7.0	19.7	24.9	27.7
Scandinavia	28.0	8.0	13.7	9.8	10.9	10.4
Germany*	16.1	3.5	5.3	7.3	6.5	4.6
Italy	8.1	6.2	12.1	4.4	7.1	7.7
Netherlands	3.5	11.5	2.6	2.0	4.1	2.2
Other	3.5	21.4	20.8	31.1	20.2	27.5
Total	100.0	100.0	100.0	100.0	100.0	100.0

\* 1951-1955 West Germany

Pattern of Iceland's Imports, 1938-1955  
(Percentage Distribution by Source)

	1938	1951	1952	1953	1954	1955
United States	1.2	13.0	20.3	26.5	20.2	22.7
United Kingdom	28.1	28.6	20.7	11.5	11.4	10.8
Soviet Bloc	1.9	10.1	6.6	8.5	18.4	22.2
Scandinavia	31.8	11.5	11.8	11.9	13.6	12.8
Germany*	23.6	4.7	4.5	6.2	8.1	10.1
Italy	8.8	3.0	1.0	1.1	2.1	1.6
Netherlands	1.0	3.8	2.5	3.1	3.1	4.5
Other	3.6	25.3	32.6	31.2	23.1	15.3
Total	100.0	100.0	100.0	100.0	100.0	100.0

\* 1951-1955 West Germany

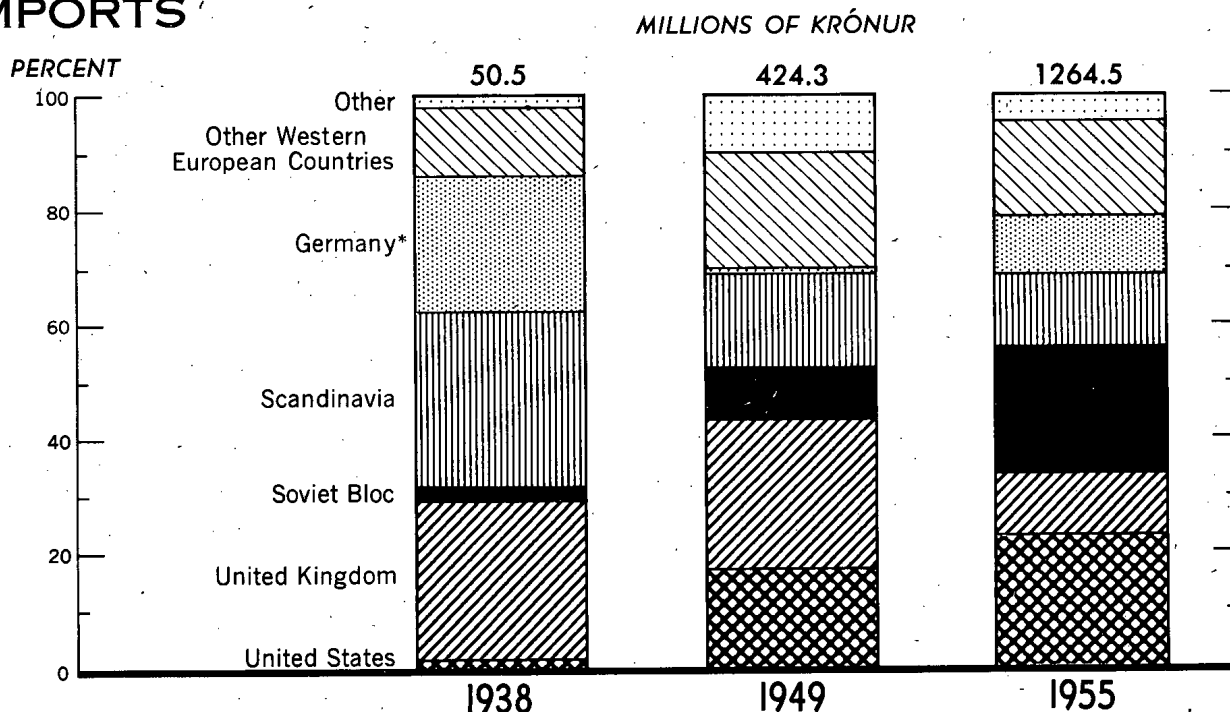
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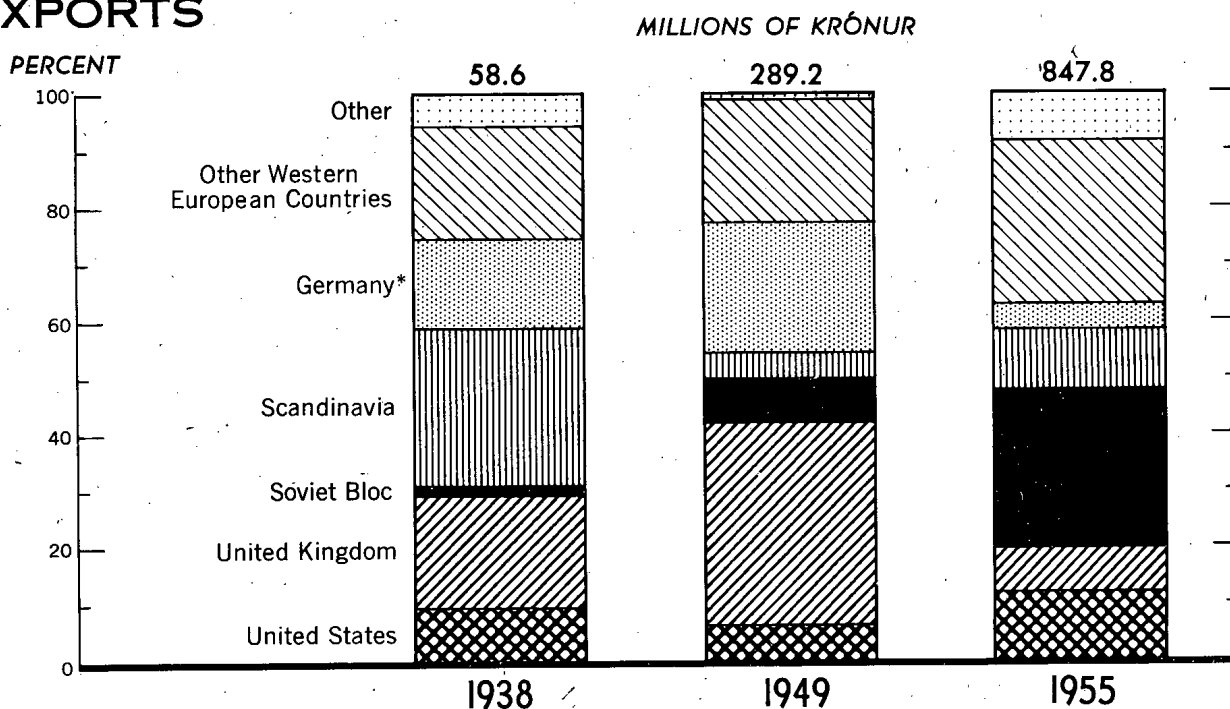
APPENDIX A

# GEOGRAPHIC DISTRIBUTION OF ICELANDIC FOREIGN TRADE 1938, 1949, and 1955

## IMPORTS



## EXPORTS



\*In 1949 and 1955 only West Germany

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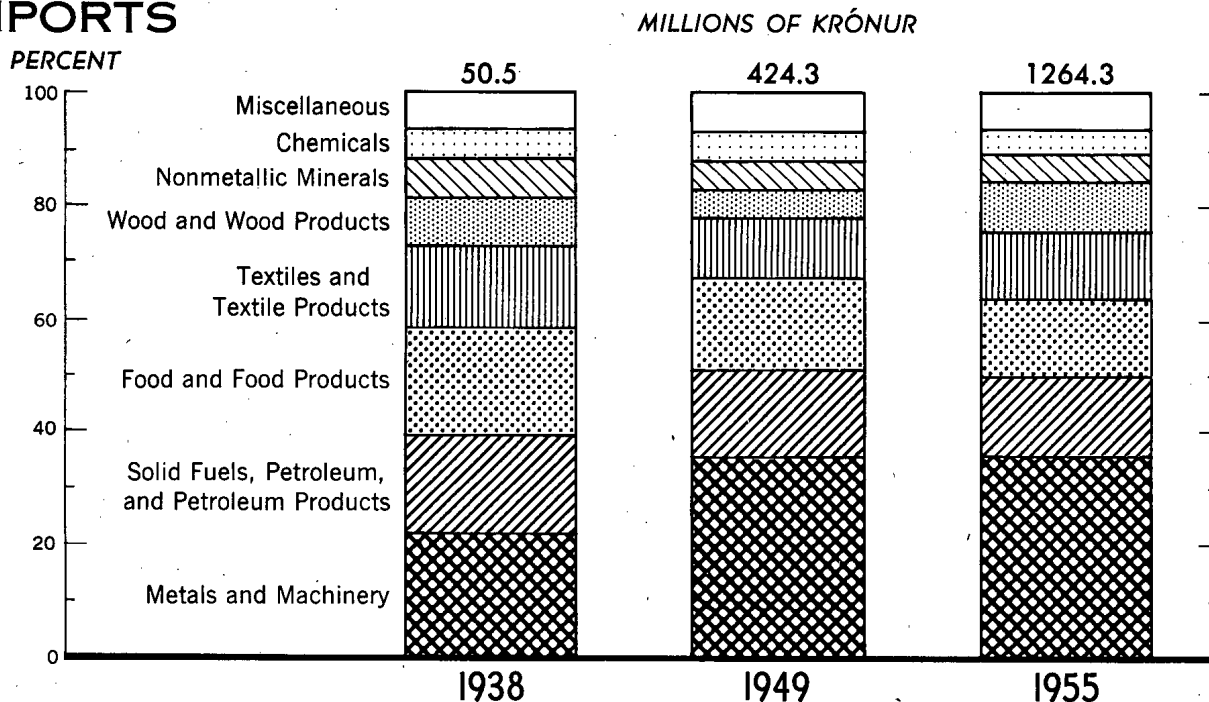


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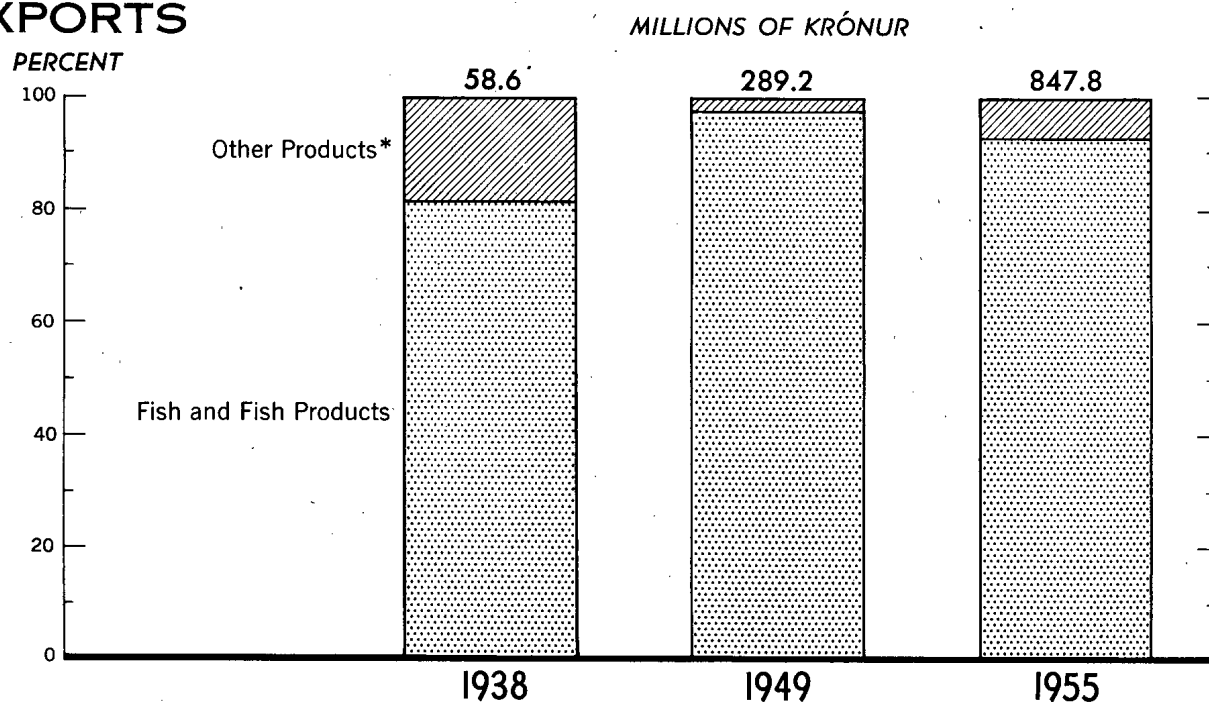
APPENDIX A

# COMMODITY DISTRIBUTION OF ICELANDIC FOREIGN TRADE, 1938, 1949, and 1955

## IMPORTS



## EXPORTS



\*Includes hides, skins, and furs; wool and wool products;  
meats, fats, and dairy products.

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*Distances from Keflavik are in nautical miles.*

Distances from Keflavik are in nautical miles.

ICELAND

STRATEGIC LOCATIONS

Scale is true along the meridian

0 500 1000 1500 2000 KILOMETERS

0 500 1000 1500 2000 MILES

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The international boundaries shown on this map do not necessarily correspond in all cases to the boundaries recognized by the U. S. Government.

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Scale is true along the meridian

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